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EXPRESSIONS HAIR DESIGN, LINDA FIACCO, BROOKLYN FARMACY & SODA FOUNTAIN, INC., PETER FREEMAN, BUNDA STARR CORP., DONNA PABST, FIVE POINTS ACADEMY, STEVE MILLES, PATIO.COM AND DAVID ROSS,

Petitioners,

v.

ERIC T. SCHNEIDERMAN, IN HIS OFFICIAL CAPACITY AS ATTORNEY GENERAL OF THE STATE OF NEW YORK; CYRUS R. VANCE , JR., IN HIS OFFICIAL CAPACITY AS DISTRICT ATTORNEY OF NEW YORK COUNTY; KENNETH P. THOMPSON, IN HIS OFFICIAL CAPACITY AS DISTRICT ATTORNEY OF KINGS COUNTY,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR CONSUMER ACTION AND NATIONAL ASSOCIATION OF CONSUMER ADVOCATES AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*

Amici curiae are two leading consumer advocacy groups whose decades of collective experience advocating for consumers make them qualified to assist the Court in understanding the substantial public interest at issue here. Amici have broad knowledge about the history of credit cards and are particularly well qualified to assist the Court in understanding how the public interest, and consumer interests in particular, are undermined by no-surcharge laws, which were originally advanced by the credit card industry and opposed by consumer-advocacy groups.[1]

Consumer Action has been educating consumers on credit card related matters, including credit card surcharges, for more than four decades. Consumer Action has been a champion of underrepresented consumers since 1971. A national, nonprofit 501(c)(3) organization, Consumer Action focuses on financial education that empowers low to moderate income and limited-English-speaking consumers to financially prosper. It also advocates for consumers in the media and before lawmakers to advance consumer rights and promote industry-wide change particularly in the fields of credit, banking, housing, privacy, insurance and utilities.

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1 The parties consented to the filing of this Brief and such consents are being submitted herewith. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amicus curiae, its members, or its counsel made a monetary contribution to its preparation or submission.

National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country and serving as a voice for its members as well as consumers in the ongoing effort to curb unfair and abusive business practices.

INTRODUCTION AND SUMMARY OF ARGUMENT

American merchants pay the highest fees on credit card transactions in the world, fees that are many times higher than the fees paid by merchants in most other developed countries. It is estimated that merchants incur upwards of $50 billion of swipe fees per year. Merchants have no choice but to pass on these credit card costs to consumers in the form of higher retail prices on the goods and services they purchase every day. The main reason that there is not more awareness and outcry about this issue is that swipe fees are hidden from consumers.

All states allow merchants to recover the cost of swipe fees, but New York and nine other states prohibit merchants from describing the price difference as a surcharge. By prohibiting merchants from informing consumers about the costs of credit card use, no-surcharge laws hinder consumers' ability to make meaningful and cost conscious decisions about payment choice. No-surcharge laws deprive merchants of a valuable tool that

could otherwise be utilized to help remedy the grossly inefficient and anticompetitive payment system.

Amici curiae are national consumer advocacy organizations that support reversal of the decision below and file this brief to make four primary points. *First*, the New York no-surcharge law results in supra-competitive interchange fees that, as a practical matter, merchants are forced to recoup by raising prices for all consumers. *Second*, the no-surcharge law results in highly regressive cross subsidies of high cost credit cards and rewards programs by other consumers—which, "[i]n the most extreme terms, . . . mean that first-class upgrades from frequent flier miles are subsidized by food stamp recipients." Elizabeth Warren, *Antitrust Issues in Credit Card Merchant Restraint Rules*, Tobin Project Risk Policy Working Group, 1 (May 6, 2007). *Third*, less restrictive means—in the form of disclosure requirements rather than speech codes—are available to protect consumers from potential merchant abuses. *Fourth*, none of the proffered justifications for the law stands up to scrutiny.

ARGUMENT

I. NO-SURCHARGE LAWS FORCE MERCHANTS TO RECOUP SUPRA-COMPETITIVE SWIPE FEES BY RAISING STICKER PRICES FOR ALL CONSUMERS.

To adequately understand the policy considerations relating to no-surcharge laws, one must first understand the merchant fees that comprise the underlying problem. Every time a consumer uses a credit card, the merchant

pays 1–4%[2] of the transaction value in "swipe fees," most of which go to the issuing bank as "interchange fees."[3] Interchange fees in America are the highest in the world, generating approximately 50 billion dollars per year for credit card issuers, with more than 200 million dollars of it from federal agencies alone.[4] Interchange fee rates jumped 23% between 2000 and 2006, and because the volume of credit card transactions also increased dramatically, the absolute cost of interchange fees for merchants increased 139% during the same period.[5] "For many merchants, credit card acceptance has become the fastest growing cost of doing business."[6]

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2 These fees are usually a hybrid of a per-transaction price and a percent of transaction cost, and sometimes can reach 15%, depending on the risk factor of the merchant. *See* Elizabeth Warren, *Antitrust Issues in Credit Card Merchant Restraint Rules*, Tobin Project Risk Policy Working Group, 1 (May 6, 2007).

3 These fees are technically divided between three banking entities, but for the purposes of this brief, the technical structure of credit card payment systems is irrelevant. *See* Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. Rev. 1321 (2008).

4 *See, e.g.*, Keith Bradsher, *U.S. Looks to Australia on Credit Card Fees*, N.Y. Times, (Nov. 24, 2009), *available at* http://www.nytimes.com/2009/11/25/your-money/credit-and-debit-cards/25card.html?pagewanted=all; Andrew Martin, *Card Fees Pit Retailers Against Banks*, N.Y. Times (Jul. 15, 2009), *available at* http://www.nytimes.com/2009/07/16/business/16fees.html.

5 Levitin, *supra* note 3, at 1345.

6 Levitin, *supra* note 3, at 1345 (citing *Financial Services Issues: A Consumer's Perspective, Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Institutions*, 108th Cong. 115 (2004) (statement of John J. Motley III, Sr. Vice President, Food Marketing Institute)).

No-surcharge rules have helped to enable credit card use to increase despite being "more expensive on average for merchants than cash and checks,"[7] by limiting merchants' ability to pass these fees to the consumers who choose to use credit cards. By returning a small portion of the swipe fee revenues in the form of rewards to a fraction of consumers, credit card companies have constructed a system whereby consumers actively, and unknowingly, choose the most costly payment system. Increased swipe fees fuel greater rewards, which fuel greater use, in a race to the top—precisely the opposite of competitive pricing.

This potent combination of greater demand for credit card use and increasing swipe fees has forced merchants to increase retail sticker prices to all consumers to recoup their credit card costs. "[H]undreds of thousands of merchants . . . must take credit cards at any price because their customers insist on using those cards." *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 341 (S.D.N.Y. 2001) *aff'd*, 344 F.3d 229 (2d Cir. 2003).[8]

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7 David S. Evans & Richard Schmalensee, Interchange Fees in Credit and Debit Card Industries, Proceedings of the 2005 Federal Reserve Bank of Kansas City Conference, *The Economics of Interchange Fees and Their Regulation: An Overview*, 96 (2005), *available at* https://www.kansascityfed.org/publicat/pscp/2005/Evans-Schmalensee.pdf.

8 *See also United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 340-41 (S.D.N.Y. 2001) *aff'd*, 344 F.3d 229 (2d Cir. 2003)); General Court of the European Union, T-111/08, *MasterCard Inc. et al., v. Commission* (2012), 28 ("[T]he MasterCard payment organisation [sic] collectively exert market power vis-à-vis merchants and their customers."), *available at* http://curia.europa.eu/juris/document/document.jsf?docid=123081&mode=req&pageIndex=1&dir=&occ=first&part=1&text=&doclang=EN&cid=443823.

Simultaneously, no-surcharge laws impede merchants' ability to communicate or allocate the cost of credit card usage to the consumers who impose the cost by choosing to pay with credit cards. To cover the costs of credit card merchant fees, merchants are forced to raise the unified sticker prices for all their goods. Cash buyers pay higher retail prices than they otherwise should, while credit card customers are discounted from the true cost of their transaction. Credit card consumers receive all the benefits of credit card use, while cash customers receive no benefit and pay a premium to cover the difference—a pervasive cross-subsidy operating on all transactions. As Elizabeth Warren has put it: No-surcharge rules operate to force most merchants "to charge *all* consumers higher prices in order to cover the costs of accepting credit card transactions. As a result, non-credit consumers (food stamps, cash, checks, debit) end up subsidizing credit card consumers and, indirectly, subsidizing the entire credit card industry."[9] The estimated overall cross-subsidy between cash and credit users is staggering: "On average, each cash buyer pays $149 to card users and each card buyer receives $1,133 from cash users every year."[10]

The explosion in rewards card programs has exacerbated the problem of hidden cross-subsidies considerably. "Rewards cards have risen from less than 25 percent of new card offers in 2001 to nearly 60 percent in 2005" and now are considered to "drive the growth

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9 Warren, *supra* note 2, at 1.

10 *See* Scott Schuh, *et al.*, Federal Reserve Bank of Boston, *Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations*, 3 (2010).

in . . . all credit card usage."[11] The power of rewards to increase credit card usage—though vitally, not to increase overall consumer spending—is closely tied with increases in swipe fees. In fact, rewards cards and corporate cards sometimes cost merchants twice as much in fees.[12] In 2007, Visa's ultra-premium rewards card's interchange rate at large supermarkets—among the merchants with theoretically the most leverage to negotiate fees—was 2.20% plus 10¢ per transaction, roughly double the average interchange fee.[13] Likewise, MasterCard's premium rewards card's interchange is as much as 3.25% per transaction.[14]

Far from being a problem for credit card networks, the across-the-board price increases work in their favor: "Card networks have the incentive to charge high interchange fees to inflate retail prices so that they can create more demand for their services . . . . As the card payments become more efficient and convenient than alternatives, the card networks are able to further raise the interchange fees, inflate the value of transactions and hence extract more profits" without benefiting either consumer surplus or merchant profits.[15] Neither merchants nor non-credit card users gain any marginal

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11 Levitin, *supra* note 3, at 1344–46.

12 Levitin, *supra* note 3, at 1323.

13 Levitin, *supra* note 3, at 1348.

14 Levitin, *supra* note 3, at 1333.

15 Zhu Wang, *Market Structure and Credit Card Pricing: What Drives the Interchange?*, 28 Int'l J. of Indus. Org. 86, 93 (2010), *available at* http://www.frbatlanta.org/news/CONFEREN/08payments/08payments_Wang.pdf.

benefit from these high-end rewards cards, but they both end up footing the bill for immense credit card company profits, and the generous rewards they provide to a tiny segment of consumers.

No-surcharge laws like New York's gag merchants and deny consumers vital information about the relative costs of payment forms, ensuring that cards are never put into serious price competition with each other or with other payment forms. But, as this case demonstrates, price signals are essential to a free market economy. *See Bates v. State Bar of Ariz.*, 433 U.S. 350, 364 (1977). In a less competitive environment, companies have less incentive to price competitively and prices therefore increase. *Id.* at 377-78. Commercial speech restraints like the ones at issue thwart price competition. Thus, credit card companies will continue to engage in a race to the top by increasing swipe fees, without concern that consumer usage will be impacted.[16] No-surcharge laws aid in maintaining unified pricing at the point-of-sale, concealing from consumers that credit card users are free riding on cash consumers and simultaneously driving retail prices up. Meanwhile, merchants have no choice but to accept credit card networks' swipe fee increases.

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16 Levitin, *supra* note 3, at 1341 (citing Merchant Discount Fees, Nilson Rep., Aug. 2006, at 11; U.S. Interchange Fees, Nilson Rep., May 2003, at 10).

II. THE CROSS-SUBSIDIES CREATED BY NO-SURCHARGE LAWS ARE HIGHLY REGRESSIVE.

Credit card companies direct a small fraction of their supra-competitive profits to their richest customers at the cost of low-income consumers, effectively implementing a regressive tax on all consumers. Consumers using "cash"—which for purposes of this brief includes checks, debit cards, and food stamps—unknowingly pay a premium that subsidizes the credit card networks and their high income consumers. The distribution of the benefits is no accident: credit card companies almost exclusively target affluent consumers and corporate accounts for the most generous rewards.[17]

On average, cash consumers are far lower income, and embrace a larger proportion of minorities, than credit card users.[18] Ten percent of adult Americans are completely "unbanked" and therefore ineligible for credit cards.[19] Within the lowest income quintile of Americans, 29% are unbanked.[20] Credit cards are also disproportionately

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17 Levitin, *supra* note 3, at 1346 n.76 (citing Burney Simpson, *Merchants Tackle Credit Card Fee Policies*, Cards & Payments, 32 (Jan. 2006)).

18 *Id.*; *see also* William C. Dunkelberg & Robert H. Smiley, *Subsidies in the Use of Revolving Credit*, 7.4 J. Money, Credit & Banking 477 (1975).

19 Warren, *supra* note 2, at 1.

20 Adam J. Levitin, *Priceless? The Social Costs of No-Surcharge Rules*, Business, Economics and Regulatory Policy Working Paper Series No. 973974, 44 (Jan. 2008 Revision)

unavailable to minorities: "While less than 5% of the white, non-Hispanic population lacks a bank account, 20% of non-whites and Hispanics are unbanked."[21] Approximately 40% of the lowest income quintile of Americans have a credit card, while 67% of households with income of $20-$50 thousand per year, and 97% of households over earning over $120 thousand per year have at least one credit card.[22] Naturally, the distribution of access to credit cards means that this cross-subsidy overwhelmingly benefits high income consumers: "credit card spending by high-income consumers is nearly five times higher than credit card spending by low-income consumers, and . . . high-income consumers are 20 percentage points more likely to receive credit card rewards."[23] No-surcharge laws help facilitate this massive transfer of resources from cash users to credit card users, and even among credit card users, from low-income, low-rewards card users to high-income, high-rewards card users. Never having to bear the costs of their usage, rewards card users use credit cards more often and more exclusively than those without rewards credit cards.[24] "By far, the bulk of the transfer gap is enjoyed by high-income credit card buyers [income $100k+], who receive a $2,188 subsidy every year," as opposed to the low income credit card buyers, who "receive a subsidy [of]

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21 *Id.*

22 Schuh, *supra* note 10, at 8.

23 Schuh, *supra* note 10, at 8.

24 Andrew Ching & Fumiko Hayashi, Federal Reserve Bank of Kansas City, *Payment Card Rewards Programs and Consumer Payment Choice*, Working Paper No. 06-02, 4 (2006), *available at* http://www.kansascityfed.org/PUBLICAT/PSR/RWP/ching_hayashi_paper.pdf.

$613."[25] In absolute terms, the estimated transfer is about $1.4 billion to $1.9 billion from non-rewards consumers to rewards consumers on gasoline and grocery purchases alone.[26] Together, the no-surcharge laws support a unified-pricing mandate and run-away rewards programs, which are largely responsible for this enormous regressive and hidden wealth transfer. In effect, this allows credit card companies to tax the poor and give a small share of those proceeds to the rich.

III. NO-SURCHARGE LAWS DECREASE CONSUMER WELFARE.

So-called "network effects"—which predict that a decrease in a network's size will result in a decrease in the network's value for its remaining participants—do not support a ban on describing credit card fees as surcharges.[27] To the contrary, even if surcharging caused a decrease in credit card usage, it would increase overall consumer welfare because: *first*, some transactions will likely be diverted to other more inexpensive payment forms, like debit, which have their own network effects that will offset "harm" to credit card networks; and *second*, credit card usage has specific externalities which undermine the facile assumption that more credit card debt means more consumer welfare.

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25 Schuh, *supra* note 10, at 21.

26 *Id.* at 3 (citing Efraim Berkovich, *Card Rewards and Cross-Subsidization in the Gasoline and Grocery Markets*, Rev. of Network Econ. 11.4 (2012)).

27 *See* Levitin, *supra* at note 3, at 1385–90.

A. Increased Use of Other Payment Forms, Like Debit Cards, Along With Reductions in Swipe Fees, Will More than Offset the Welfare Costs of Decreased Credit Card Usage.

Surcharging will create genuine competition between payment forms, benefiting debit card users and driving down swipe fees for everyone. Because many other payment forms are subject to network effects, the diverted credit card usage would create comparable welfare gains in other networks. So the marginal loss to credit card users would be offset by the benefits to debit users. In fact, for newer payment forms, adoption matters a great deal more. By the time networks are as well-established and mature as credit cards, "the adoption and usage externality has become less important."[28] The qualities that most consumers cite as their reasons for using credit cards – convenience, security from theft, widespread acceptance, speed at checkout – are fully replaceable by other payment forms like debit cards, at *half* the cost.[29]

States have no legitimate interest in artificially sparing credit cards from free and open competition with other payment forms. If no-surcharge laws are necessary to maintain credit cards' position vis-à-vis other payment forms, it is preserving a market failure that substantially harms consumers. The Supreme Court has rejected state attempts to restrict advertising based on

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28 Wang, *supra* note 15, at 95.

29 Evans & Schmalensee, *supra* note 7, at 96. Many debit cards actually offer superior security through the use of pin systems and because debit card fraud does not affect a consumer's credit report, whereas credit card fraud does. Levitin, *supra* note 5, at 1387.

the "fear that people would make bad decisions if given truthful information." *Thompson v. W. States Med. Ctr.*, 535 U.S. 357, 374 (2002); *Bates*, 433 U.S. at 364 (holding that commercial speech "performs an indispensable role in the allocation of resources in a free enterprise system"). In fact, the most likely and significant outcome of allowing merchants to surcharge is decreased swipe fees. There is evidence that "no surcharge rules increase the price of all other payment systems to match the price of credit cards,"[30] explaining why interchange fees in the United States are more than double those in some other countries (Australia, EU cross-border, and the UK).[31] Australia's ban on no-surcharge rules immediately led to increased debit usage, while the average swipe fee fell by nearly half, across the board.[32] Significantly, it also led to increased volume on its network.[33] Moreover, even without no-surcharge rules, credit card companies continue to

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30 Levitin, *supra* note 3, at 1358 (citing Joseph Farrell, *Efficiency and Competition Between Payment Instruments*, 5 Rev. Network Econ. 26, 31 (2006)). Under current common contract terms, no credit card issuer would benefit from lifting the restraints unilaterally because the other, presumably more costly, credit card companies would still be protected by their own no surcharge rules. *See* Levitin, *supra* note 5, at 1359.

31 Stuart E. Weiner & Julian Wright, *Interchange Fees in Various Countries: Developments and Determinants*, 4.4 Rev. of Network Econ. 299 (2005), *available at http://www.academia.edu/3095968/Interchange_Fees_in_Various_Countries_Developments_and_Determinants.*

32 Reserve Bank of Australia Payment Statistics, Bulletin Table C3, Average Merchant Fees for Debit, Credit and Charge Cards, http://www.rba.gov.au/statistics/tables/xls/c03hist.xls.

33 Levitin, *supra* note 3, at 1389.

profit in Finland, the Netherlands, Portugal, Sweden, the United Kingdom, Switzerland, and Australia.[34] Similarly, the European Commission, following an extensive investigation, found that interchange fees imposed a "restriction on price competition [and] harms businesses and their customers" and determined that removing such restrictions would "foster[] greater competition in the cards market and prevent[] an artificial increase of merchant fees due to an illegal pricing mechanism...."[35]

In light of these real world examples, it is impossible to say with a straight face that no-surcharge rules really help consumers. On balance, the effects the decreased network effects for credit users are dwarfed by the gains in efficient market allocation. No-surcharge laws may be vital to the preservation of supra-competitive profit margins for credit card companies, but there is no economic theory that can twist this interest into a pro-consumer justification of the law.

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34 Levitin, *supra* note 3, at 1389 n.241. For an overview of global regulation of interchange fees, *see* Terri Bradford & Fumiko Hayashi, Federal Reserve Bank of Kansas City Payments System Research Briefing, *Developments in Interchange Fees In the United States and Abroad*, (Apr. 2008), *available at* http://www.kansascityfed.org/publicat/psr/briefings/psr-briefingApr08.pdf.

35 Antitrust: Commission prohibits MasterCards intra-EEA Multilateral Interchange Fees, Commission Européenne (Dec. 19, 2007), *available at* http://europa.eu/rapid/press-release_IP-07-1959_en.htm?locale=fr.

B. Overconsumption of Credit Card Debt Causes Uniquely Harmful Social Externalities.

A supposedly pro-consumer defense of no-surcharge laws based on spurring expanded use of credit cards is radically out of step with the facts of credit card debt consumption. Credit card debt in America was $870 billion by May of 2012.[36] Moreover, "Americans racked up nearly $48 billion in new credit card debt in 2011, 424 percent more than what they charged in 2010, and 577 percent more than in 2009.[37] Although total outstanding credit rose only about $4 billion, that number was largely offset by the magnitude of consumer defaults—*$44.2 billion worth.*"[38] As a result of a phenomenon unique to credit card debt, consumers consistently underestimate both the credit debt they already hold, and the costs they will eventually incur. In 2011, Americans held an average of $7,134 in credit card debt per household, but reported themselves as having an average of $2,000 less.[39] Credit card usage

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36 The Associated Press, *Consumers Take on More Debt*, N.Y. Times, (Jul. 9, 2012), *available at* http://www.nytimes.com/2012/07/10/business/credit-card-debt-climbed-by-8-million-in-may.html?_r=0.

37 Meg Handley, *Consumers Still Buried In Credit Card Debt*, U.S. News and World Report (Mar. 12, 2012), *available at* http://www.usnews.com/news/articles/2012/03/12/consumers-still-buried-in-credit-card-debt (emphasis added).

38 *Id.*

39 Meta Brown, *et al.*, Federal Reserve Bank of New York, *Do We Know What We Owe? A Comparison of Borrower- and Lender-Reported Consumer Debt* (Revised Oct. 2013), *available at http://www.newyorkfed.org/research/staff_reports/sr523.pdf*; *see also* Oren Bar-Gill, *Seduction by Plastic*, 98 Nw. U. L. Rev. 1373, 1396–402

is also causally linked to personal bankruptcy, and credit card companies target bankrupt and near-bankrupt households with predatory offers.[40] Following the ban on no-surcharge rules, Australia saw a 43% decrease in the gross of credit card debt.[41] A comparable reduction in the growth of American credit card debt, far from being a cost of surcharging, would be a highly desirable side effect.

IV. THE STATE'S JUSTIFICATIONS CANNOT SURVIVE INTERMEDIATE SCRUTINY AND ALTERNATIVE, LESS RESTRICTIVE MEANS ARE READILY AVAILABLE TO PROTECT CONSUMERS FROM POTENTIAL MERCHANT ABUSES.

The New York Attorney General offered three purported justifications for the no-surcharge law: (1) that "customers view [credit] surcharges as unjustified penalties," which "can cause consumer[s] anger and 'dampen retail sales,'" while "customers view cash discounts more positively," which "can actually encourage consumer spending," NY CA2 Br. 9, 11; (2) that "surcharges are much more strongly associated than discounts are with

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(2004); Levitin, *supra* note 20, at 50–52 (describing various studies outlining consumer under appreciation of the cost of credit).

40 *See* Teresa A. Sullivan, Elizabeth Warren, Jay Lawrence Westbrook *Credit Cards* at 108, The Fragile Middle Class: Americans in Debt, Yale University Press (2000) (outlining the connection between credit card usage and bankruptcy); Levitin, *supra* note 20, at 43.

41 *See* Adam J. Levitin, *The Antitrust Superbowl: America's Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 Berk. Bus. L. J. 265, 332 (2005).

'dubious' and fraudulent sales practices" because they "make it easier for sellers to advertise a low regular price and then impose surprise credit-card fees at the point of sale," *id.* at 9-10, 43; and (3) that "sellers can and often will use surcharges to extract windfall profits from their customers," *id.* at 6. Each of these arguments falls flat, and the state's objectives can be achieved through alternative, less restrictive interventions.

The first justification, consumer unhappiness, does not provide a legitimate basis for severely curtailing the speech at issue. Indeed, the First Amendment is expressly designed to prohibit states from banning expression simply because it might be viewed as upsetting or otherwise objectionable. *See, e.g., Texas v. Johnson*, 491 U.S. 397, 414 (1989). The state's interests would be better served by ensuring that consumers have access to complete and accurate information. Regulation that keeps consumers in the dark "for what the government perceives to be their own good" is not a justification for prohibiting the dissemination of truthful information. *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 503 (1996). In fact, common sense dictates that accurate pricing information "is not in itself harmful" and "that people will perceive their own best interest if only they are well enough informed, and that the best means to that end is to open the channels of communication rather than to close them." *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 770 (1976). Moreover, the suggestion that unhappiness regarding surcharging would chill consumer spending in the aggregate is frankly implausible. It is illogical to suppose that merchants would voluntarily institute surcharges so great that they cause reductions in spending at their own businesses. To the contrary, the

resulting lower retail prices should naturally stimulate *more* consumer spending. But even if that were not true, as a matter of law, worries based on irrational merchant and consumer reactions cannot justify the no-surcharge law. *See Pearson v. Shalala*, 164 F.3d 650, 655 (D.C. Cir. 1999) (characterizing as "almost frivolous" the government's argument that certain health claims "have such an awesome impact on consumers as to make it virtually impossible for them to exercise any judgment at *the point of sale*," as if they were "hypnotized"); *Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 167 (5th Cir. 2007) ("Attempting to control the outcome of the consumer decisions . . . by restricting lawful commercial speech is not an appropriate way to advance a state interest in protecting consumers.").

The second justification, fear of deceptive sales practices, is likewise unavailing. The state has proffered no evidence to demonstrate that this concern is anything more than theoretical.[42] Even assuming however, that the state's concern is grounded in reality, the no-surcharge rule is dismally crafted (and hugely overbroad) if its aim is in fact to protect consumers from merchants who could advertise misleading sticker prices and thereby engage in a "bait and switch."[43] Moreover, as a practical

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42 This is further supported by the fact that every major consumer advocacy organization, including Consumers Union and Consumer Federation of America, have long opposed state no-surcharge laws. *See* JA 103-104; *see also* Irvin Molotsky, *Extension of Credit Surcharge Ban*, N.Y. Times, Feb. 29, 1984,(quoting Senator William Proxmire, stating in debate on the Senate floor that "[n]ot one single consumer group supports the proposal to continue the ban on surcharges."), *available at* http://www.nytimes.com/1984/02/29/business/extension-of-credit-surcharge-ban.html.

43 A related defense of the no-surcharge rule argues that two-tiered pricing interferes with consumers' ability to comparison shop.

matter, enforcement of states' existing false and deceptive advertising laws would accomplish the same goal far less restrictively and more effectively. *See* N.Y. Gen. Bus. Law § 349. In addition to general prohibitions against deceptive advertising, the state could institute credit-card specific disclosure requirements to guard against abusive two-tiered pricing. For example, disclosure requirements like those proposed by the Federal Reserve Board would entirely protect consumers from deceptive surcharging.[44] *See Cash Discount Act, 1981: Hearings on S. 414 Before the Senate Banking Comm.*, 97th Cong., 1st Sess. 10 (Feb. 18, 1981) (proposing "a very simple rule": that both surcharges and discounts be allowed and "the availability of the discount or surcharge be disclosed to consumers."). Thus, existing anti-deception law or a more narrowly tailored requirement to give notice for credit card surcharges entirely dispose of concerns that consumers would be harmed by misleading prices

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There is no logic to this argument as a justification for disallowing surcharging while permitting discounts as "there is no reason to think that a comparison of maximum prices (allowing discounts, not surcharges) is any better than a comparison of minimum prices (allowing surcharges, not discounts)." Levitin, *supra* note 3, at 1383. Because discounts and surcharges are mathematically equivalent, allowing one and not the other relies on an impermissible "underestimation of the public," *Bates*, 433 U.S. at 375, especially if merchants are required to disclose their pricing structure.

44 *See* S. Rep. No. 97023, at 11–12 (1981); Council Directive 98/6, art. 3, 1998 O.J. (L 80) 28 (EC) (directing member states to adopt regulations requiring merchants to indicate both selling price and unit price for all covered products); *see also* Levitin, *supra* note 3, at 1384.

The third justification, windfall profits, is also meritless and can be addressed through far less restrictive means. As with the deceptive sales practice justification, the state has failed to offer any evidence, empirical or otherwise, to substantiate this concern. Indeed, the very study the state cited to advance its argument concedes as much. *See* Marc Rysman & Julian Wright, *The Economics of Payment Cards*, 16 (Nov. 29, 2012) (Working Paper, Boston University & National University of Singapore) (acknowledging that "empirical research on surcharging behavior would be very valuable"). Even assuming windfall profits are a real concern, the state's purported objectives can be achieved through less restrictive means that do not offend the First Amendment. For example, price differences (whether framed as a surcharge or a discount) can be capped, ensuring that surcharges for credit card users are within reasonable bounds, as it is in Minnesota. *See* Minn. Stat. Ann. § 325G.051(1)(a) ("the surcharge [may] not exceed five percent of the purchase price"). This would satisfy the state's purported objectives without hampering the free-flow of accurate information between merchants and consumers. In any case, credit card companies have far overstated the danger posed by surcharging because the marketplace, through consumer reactions, will naturally discipline merchants who would seek to abuse the right to describe a price difference as a surcharge. As a matter of fairness, sparing consumers who prefer credit cards the burden of weighing their preference against the savings of other payment systems is hardly a substantial state interest, worth imposing those costs on cash consumers, who have no choice but to pay for services from which they derive no benefit.

CONCLUSION

For the foregoing reasons, this Court should reverse the Second Circuit's decision.

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Respectfully submitted,

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